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The Director of Central Intelligence

Washington, D.C. 20505

Resource Management Staff

DCI/RM/80-1456

28 October 1980

MEMORANDUM FOR: See Distribution

FROM:

[REDACTED]
Deputy Director, Program and Budget Office

SUBJECT:

Comments on FY 1982 NFIP Inflation Estimate

Attached for your comments by COB Tuesday, 28 October is a paper on inflation which is intended for distribution to the NFIB by Thursday, 30 October. Please call me on extension [REDACTED] if you have any further questions.

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Background Paper on FY82 NFIP Inflation Estimate

I. The purpose of this paper is to estimate as a benchmark the FY 1982 NFIP Budget level which would equate in real terms to that for FY 1981; i.e., a no growth level.

For the last three years inflation has had a large and growing effect on the programming and budgeting process of the NFIP. Over this time unexpectedly high rates of inflation have imposed real declines in capability on many parts of the NFIP. It has also made it considerably more difficult to assure that planning in the NFIP is both realistic and frugal by confounding the relationship of program growth and cost growth. Finally, there is dissatisfaction on the part of all those involved in the Community's budget review process with the problems created by the disparate ways inflation has been treated in the budget submissions.

There are several troublesome aspects to dealing with the NFIP inflation problem. The first involves the difficulty in predicting inflation rates given the economic fluctuations experienced over this time period. Despite a general climb in inflation, there has been no steady pattern; in fact, in several quarters over the last three years declines in the rate of inflation have occurred. This highly variable rate of inflation has frustrated planning and made inflation a continuing concern, and yet, due to the nature of the budgeting process, at some point future spending plans are fixed and at that point the process does not permit further adjustments in projected rate of inflation. Since there are strong incentives for the government to predict declines in inflation over time, more often than not the difference between the actual and projected rate of inflation has been to the disadvantage of the NFIP programs.

The NFIP also suffers because a relatively high proportion of its expenditures are made in foreign markets that have been affected by increasingly unfavorable exchange rates as well as differing local inflation rates and in domestic markets in economic sectors that are among the most volatile, namely; aerospace, and ADP.

Finally, since the NFIP is composed of a variety of programs each of which experiences different inflation problems and each of which accounts for costs and hence cost growth somewhat differently, NFIP inflation is difficult to estimate systematically.

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II. Despite these dissimilarities, the Resource Management Staff (RMS) has estimated an overall inflation rate for the FY82 NFIP. We use a weighted average of individual program estimates. Each program estimate is, in turn, based on internal procedures, some adhering to OSD guidelines, others to procedures that program managers judge to reflect their inflation problem more accurately.

This approach has several obvious drawbacks (including an inability to make comparisons at other than aggregate program levels), but in light of the extensive details on inflation provided by each program in the joint RMS/OMB budget hearings, this estimate provides a realistic and accurate reflection of how inflation affects the NFIP.

III. Figure III-1 summarizes the new RMS FY82 inflation estimates for individual programs and for the NFIP as a whole. Table III-1 provides a detailed breakout of each program estimate. A brief overview of each estimate is provided below.

NRP

The NRP estimate for FY82 inflation is 10.5 percent. This estimate is based on a system-by-system assessment of inflation made by each program office. The estimating technique is to apply approved/negotiated forward pricing rates or an aerospace industry space-related projected inflation rate such as those published by the Space Division of the Air Force Systems Command to work already on contract and OSD/OMB raw inflation rates to work not yet on contract. A weighted average of these rates results in the overall NRP estimate. This estimate compares favorably to an alternative estimate made by the NRO based on DoD appropriation cost categories and OSD Comptroller deflators. This technique yields an FY82 estimate of 11 percent.

CIAP

The CIA, FBI, DoE, State/INR, IC Staff and Treasury base their inflation estimates on price indices for a set of major object class cost categories for actual foreign and domestic expenditures. The CIA indices for all non-personal services categories are based on statistical regression analyses. For each category, the explanatory variable is the U.S. Consumer Price Index (CPI), converted to a fiscal year basis. Regression coefficients are applied to forecasts of percentage changes in the CPI from Data Resources Incorporated. Estimates of price indexes for foreign expenditures are based on recent changes observed for foreign exchange rates and foreign price indexes and projected rates of increase for the U.S. CPI.

The personal services index simply applies the recent pay act outyear increase of 9.0 percent for FY82.

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Using these estimates, a weighted average of 10.5 percent was computed for the CIAP; 9.1 percent for FBI, 13.1 percent for DoE; 9.1 percent for State/INR; 9.2 percent for Treasury and 8.9 percent for the IC Staff.



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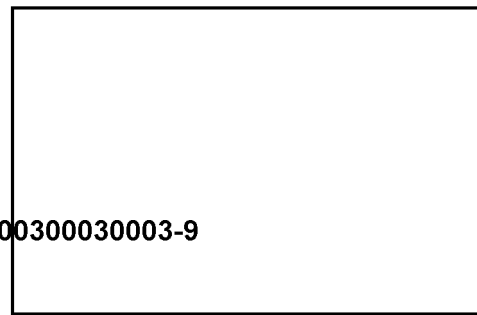
A weighted average by program of estimated inflation for the NFIP as a whole is 9.61 percent.

There is a consistency in these estimates that highlights the special inflation problems of the NFIP and thus, the need for special inflation consideration. If we separate NFIP programs by DoD accounting and object class categories, we see two relatively stable inflation estimates for FY 82; about 8.7 percent for programs using DoD account categories and about 10.5 percent for programs using object class categories. Those applying defense categorizations and deflators are similar because of similar cost spreads, the CIAP and NRP are higher because of their special circumstances. The CIAP inflation estimate is driven by overseas costs that run at almost double domestic inflation rates. The NRP is influenced by high inflation rates for materials and services in the aerospace industries. The relative balance of these two groups in the NFIP yields and overall average of 9.64 percent inflation.



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